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IN THE

Supreme Court of the United States

OCTOBER TERM, 1955.

No. 937

CONTINENTAL CAN COMPANY, INC.,
Petitioner,

against

PAUL MAGIDA, a stockholder of THE VULCAN DETINNING COMPANY, suing on behalf of himself and all other stockholders similarly situated and on behalf and in the right of THE VULCAN DETINNING COMPANY,

and

THE VULCAN DETINNING COMPANY,
Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

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ment of contemporaneous ownership of stock set forth in Rule 23(b) of the Federal Rules of Civil Procedure, adopted by order of this Court, does not apply to an action brought pursuant to Section 16(b) of the Act. This holding finds no sanction in the Act itself and is in conflict with the decisions of this Court commencing with *Hawes* v. *Oakland*, 104 U. S. 450 (1881) 9

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against

PAUL MAGIDA, a stockholder of THE VULCAN DETINNING COMPANY suing on behalf of himself and all other stockholders similarly situated and on behalf and in the right of THE VULCAN DETINNING COMPANY,

and

THE VULCAN DETINNING COMPANY,

Respondents.

TO THE HONORABLE THE CHIEF JUSTICE AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Petitioner, CONTINENTAL CAN COMPANY, INC., respectfully prays that a Writ of Certiorari issue to review a judgment of the United States Court of Appeals for the Second Circuit entered on April 2, 1956 (App. A, *infra*, p. 21) which affirmed a judgment of the United States District Court for the Southern District of New York (App., pp. 22-23)* in the sum of $44,912.27 in favor of respondent Magida and against petitioner after a trial before the District Court without a jury.

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* References are to the pages of the Appendix to Continental's brief in the Court below together with the papers constituting all the proceedings in said Court.

Opinions Below.

The opinion of the District Court (App., 15-21), announced on August 3, 1955, has not been reported.

The opinion of the Court of Appeals (App. A, *infra*, pp. 14-20) has not yet been reported.

Jurisdiction.

The judgment of the Court of Appeals (App. A, *infra*, p. 21) was entered on April 2, 1956. The jurisdiction of this Court is invoked under 28 U. S. C. §1254(1).

Questions Presented.

1. Does the policy of Section 16(b) of the Securities Exchange Act of 1934 override the public policy of the United States against illegal and champertous agreements between attorney and client as announced in the decisions of this Court?

2. In view of Rule 23(b) of the Federal Rules of Civil Procedure, can respondent Magida maintain this action pursuant to Section 16(b) of the Act despite the fact that he was not a shareholder of respondent THE VULCAN DETINNING COMPANY during the period of the complained of purchase and sale of shares of stock of THE VULCAN DETINNING COMPANY by CONTINENTAL CAN COMPANY, INC.?

Statute Involved.

Pertinent provisions of the Securities Exchange Act of 1934 and Rule 23 of the Federal Rules of Civil Procedure are set forth in App. B, *infra*, pp. 22-24.

Statement.

The action was brought by respondent Magida as a stockholder of respondent THE VULCAN DETINNING COMPANY (hereinafter referred to as "Vulcan"), pursuant to Section 16(b) of the Securities Exchange Act of 1934 (15 U. S. C. 78 p. (b)), for the recovery of profits claimed to be due to Vulcan on a purchase and sale of its common stock by Continental Can Company, Inc. (hereinafter referred to as "Continental") within a period of six months.

The complaint (App., 3-5) alleged that Continental while an owner of more than 10% of the equity securities of Vulcan, purchased some 4,115 shares of the Vulcan common stock and sold some 120,000 shares of such stock within a period of six months at a profit. It sought an accounting and payment by Continental to Vulcan of all of such profits with interest, and a reasonable fee for plaintiff's attorney. It is not disputed that the amount of the profit on the 4,115 shares in question is $34,551.85 (App., 30).

Continental's answer (App., 6-9) denied that Magida was the owner and holder of Vulcan stock and that the action was brought on behalf of the plaintiff and all other stockholders similarly situated and on behalf of and in the right of Vulcan. In addition, it pleaded as a third affirmative defense that Magida was not the owner and holder of shares of Vulcan stock during the period of the alleged purchase and sale of the 4,115 shares of Vulcan stock by Continental. Because of the holding of the Court below in *Blau* v. *Mission Corp.*, 212 F. 2d 77, the point that this defense is sufficient in law was not urged on appeal below, although expressly not waived (Appellant's brief below, p. 3).

At the trial of the action Continental moved for leave to amend its answer so as to plead a fourth separate and complete defense.

The proposed amendment charged in part that the plaintiff had not commenced the action for the benefit of Vulcan or of its stockholders but for the benefit of his attorney of record and to enable him to recover an attorney's fee; that the arrangement between the plaintiff and his attorney of record whereby the action had been instituted and prosecuted was illegal and contrary to the public policy of the United States, and that any recovery would be contrary to such public policy and would be unjust, inequitable and unconscionable* (App., 26).

The District Court ruled that the proposed fourth complete defense was insufficient in law (App., 27).

Continental made an offer of proof in support of these matters (App., 61-67) in the form of certain exhibits which were marked for identification on the trial and separately printed upon the appeal to the Court below (Ex. 1-66).**

The District Court rendered its decision for the plaintiff (App., 15-21) and the judgment provided for interest (App., 22). The Court of Appeals affirmed.

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* Continental's first affirmative defense alleged, in substance, that Vulcan, having requested Continental to sell the shares upon which the plaintiff sought to recover the profits, was estopped from claiming any such profits and that any recovery of such profits would be unjust, inequitable and unconscionable. That no such sale would have been made by Continental *except for Vulcan's request* remains uncontroverted (App., 11, 12, 33, 34, 36-39).

** Reference is to the pages of a volume containing defendant's Exhibits G-1, G-2, G-3, G-4, H, I and J, marked for identification upon the trial of this action and comprising proof in support of the proposed fourth affirmative defense.

Reasons for Granting the Writ.

1. The Court of Appeals has departed from the accepted and usual course of judicial proceedings which strikes down illegal and champertous agreements between attorney and client. It has sanctioned practices on the part of attorneys and clients which have been condemned in the decisions of this Court, e.g., *Peck* v. *Heurich*, 167 U. S. 624. In holding that the Securities Exchange Act of 1934 (15 U. S. C. 78 p. (b)) permits the maintenance of an action under Section 16(b) of the Act pursuant to an illegal and champertous agreement, it has decided an important question of federal law which has not been, but should be, settled by this Court.

2. The Court of Appeals has decided an important question of Federal law which has not been, but should be, settled by this Court and has decided it in a way in conflict with applicable decisions of this Court. Specifically, it has held in the case below, upon the authority of *Blau* v. *Mission Corp.*, 212 F. 2d 77, that the requirement of contemporaneous ownership of stock set forth in Rule 23(b) of the Federal Rules of Civil Procedure, adopted by order of this Court, does not apply to an action brought pursuant to Section 16(b) of the Act. This holding finds no sanction in the Act itself and is in conflict with the decisions of this Court commencing with *Hawes* v. *Oakland*, 104 U. S. 450 (1881).

I.

The Court of Appeals has erroneously held that it is irrelevant in a Section 16(b) action whether it is being prosecuted pursuant to an illegal and champertous agreement. This determination involves an important question of public policy that should be passed upon by this Court.

If permitted to do so, Continental intended to prove that the respondent Magida was the mere tool and dummy of his attorneys, including his attorney of record; that they were the real parties in interest and that their sole motive in prosecuting the action was to obtain a counsel fee;* that no true relationship of an attorney and client existed; and that such arrangement as did exist was champertous. This can be established directly and by inference from the pretrial depositions of respondent Magida and Mr. Markowitz, one of his attorneys. These depositions tell an utterly incredible story as to how Magida came to engage his attorneys and to commence the action. The story is that Magida commenced the action in the expectation of enhancing his gross equity interest by $1.10, while fully aware that, if unsuccessful, he would be liable for costs and expenses aggregating many hundred times that much (Ex., 1-62).

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* The attorney of record in a letter dated February 8, 1951 written in a similar suit boasted that "I have been counsel in quite a number of 16(b) suits * * *" and observed that "my interest in the success of this suit is purely selfish * * *", and further observed that "when you consider that I can only be recompensed by the corporation for the services which I render prior to the commencement of this suit from the fund it may recover upon the successful conclusion of this action, you can readily understand my interest in the case" (Ex., 63-64). *Fistel* v. *Christman*, 133 F. Supp. 300 (S. D. N. Y. 1955) is another manifestation of the same motivation.

Yet the Court below has stated that even if these matters were fully capable of proof they would be insufficient in law to defeat this action. This holding, in effect, sanctions the type of illegal and champertous agreement which has constantly been condemned by this Court as against the public policy of the United States.*

In *Peck* v. *Heurich*, 167 U. S. 624 (1897), the long established rule of this Court was enunciated. There an attorney (as co-trustee) took from his clients a deed for real property for the purpose of instituting an action to recover possession. Upon the recovery of possession or certain other events, the trustees could sell the property, retain one-third and remit to the grantors two-thirds of the money realized. This Court held that the action could not be maintained because the agreement between attorney and client was illegal and champertous, saying (167 U. S. 624, 631-632):

> "Upon the nature and effect of the agreement made by the attorney with the grantors in this deed, this court concurs in the opinion expressed by the Court of Appeals of the District of Columbia, as follows: 'He agreed to pay the costs of the litigation; he agreed to take as his compensation a part of the land which was the subject of the suit, or a part of the proceeds of sale of it, which amounts to the same

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* It is also violative of New York Penal Law, §274, and the public policy of that State. *Matter of Gilman*, 251 N. Y. 265; *Matter of Lessig*, 165 Misc. 706; *Matter of Tunnicliff*, 202 App. Div. 69 (1st Dept.); *Eisenberg* v. *Central Zone Property Corporation*, New York Law Journal, April 12, 1956, page 1 (not yet otherwise reported). In the *Eisenberg* case, the Appellate Division of the Supreme Court of New York, First Department, said, *per curiam*: "Certainly the institution of such [derivative] actions and the undertaking of litigation for the purpose of seeking a counsel fee should not be encouraged."

Accord: Canon No. 42 of The Canons of Professional Ethics of the American Bar Association; Rule 3 of Special Rules Regulating Conduct of Attorneys and Counsellors at Law in the First Judicial Department of the Supreme Court of the State of New York; 10 Am. Jur., Champerty and Maintenance, Sec. 9, p. 557.

> thing; and his compensation was not a fixed sum of money, payable out of the proceeds of sale, but a contingent share of the very thing to be recovered, or of the money that might be received by way of settlement or compromise; and the character of the enterprise, on the part of the attorney, was so plainly a speculative one, that in the deed the net results to him are mentioned as "profits". If this be not champerty, we fail to see wherein there can be champerty. We must regard an agreement by any attorney to undertake the conduct of a litigation on his own account, to pay the costs and expenses thereof, and to receive as his compensation a portion of the proceeds of the recovery, or of the thing in dispute, as obnoxious to the law against champerty; and that this was the character of the arrangement in the present case we are entirely satisfied.' * * * 6 App. D. C. 283, 284."

Merlaud v. *National Metropolitan Bank,* 84 F. 2d 238 (D. C. Cir.), cert. den. 299 U. S. 584 (1936), followed the rule in *Peck* v. *Heurich, supra,* that an agreement by an attorney at law to prosecute a law suit at his own expense is unlawful and void for champerty, and that a court in the due administration of justice is bound to refuse its aid to enforce such an agreement. In *General Film Co.* v. *Sampliner,* 252 F. 443 (6th Cir. 1918), it was held that this defense of champerty is available in an action at law.

As noted, the Court of Appeals below held that even if the proposed fourth affirmative defense was fully capable of proof, it would be insufficient in law to defeat this action brought pursuant to Section 16(b) of the Act. By so doing the Court of Appeals necessarily gave sanction to illegal and champertous arrangements entered into for the purpose of bringing Section 16(b) cases.

Confronted with the established rule of this Court in *Peck* v. *Heurich,* it endeavored to distinguish that case on

the ground that plaintiff there acquired his status through champertous acts, whereas in the instant action "plaintiff's position as vindicator of the corporate rights comes from the statute itself." But, it is respectfully submitted, there is nothing in the Act that indicates any Congressional intent to bestow such an exceptional status on a plaintiff in a Section 16(b) action. Nor is there anything in the Act which says or indicates that the ancient and all-pervasive federal public policy against illegal and champertous agreements of all kinds can be ignored in cases arising under the Act.

Certainly the question whether Congress intended to override the wise and necessary public policy against champertous and illegal agreements so firmly established in our jurisprudence is of such vital importance that it deserves the consideration of this Court.

II.

Respondent may not maintain the action because he was not a shareholder at the time of the transaction of which he complains.

It is undisputed that respondent Magida was not a stockholder of Vulcan at the time the purchase and sale of the stock in question took place (App., 28-30).

Rule 23(b) of the Federal Rules of Civil Procedure for the United States District Courts (App. B, *infra*, p. 24) requires such contemporaneous ownership on the part of a plaintiff in a derivative action.

It has long been established and, indeed, the Court below did not dispute the fact (App. A, *infra*, p. 17), that a suit brought under Section 16(b) of the Securities Exchange Act is a derivative suit in the nature of an equi-

table action. *Smolowe* v. *Delendo Corp.*, 136 F. 2d 231 (2d Cir. 1943); *Pottish* v. *Divak*, 71 F. Supp. 737 (S. D. N. Y. 1947).

The question arises, therefore, must a plaintiff who brings such a suit comply with Rule 23(b)?

Three Courts of Appeals have ruled on the question and have held that such compliance is not needed. *Dottenheim* v. *Murchison*, 227 F. 2d 737 (5th Cir. 1955), cert. den. April 30, 1956; *Blau* v. *Mission Corp.*, 212 F. 2d 77 (2d Cir. 1953), cert. den. 347 U. S. 1016; *Pellegrino* v. *Nesbit*, 203 F. 2d 463 (9th Cir. 1953). To the same effect is *Benisch* v. *Cameron*, 81 F. Supp. 882 (S. D. N. Y. 1948).

On the other hand, the District Court for the Northern District of Texas, *Murchison* v. *Dottenheim*, 127 F. Supp. 790, rev'd *Dottenheim* v. *Murchison*, *supra*, held to the contrary and in *Pottish* v. *Divak*, *supra*, the District Court for the Southern District of New York held that any compromise of an action under Section 16(b) of the Act is governed by Rule 23(c) (App. B, *infra*, p. 24), stating:

> "Since a Section 16(b) suit by a stockholder must be brought in the federal courts and since it is essentially a secondary or derivative action, it is necessary to consider the application of Rule 23 of the Federal Rules of Civil Procedure to the settlement of such suits. It should be initially noted that Rule 23(b) applies to actions by 'shareholders' i.e. those with a proprietary interest, whereas Section 16(b) applies to 'security owners,' a varied class which includes shareholders and others than those having a proprietary interest. See Yourd, Trading in Securities by Directors, Officers and Stockholders: Section 16 of the Securities Exchange Act, 38 Mich. Law Review 133, 154. When the action under Section 16(b) is brought by a shareholder it seems to me that it is a class action within the definition of

> Rule 23(a)(1) and that any compromise of the action is governed by Rule 23(c)."

The rationale of *Pottish* v. *Divak* is the obvious answer to the casual treatment of this problem in *Blau* v. *Mission Corp., supra,* where the Court below, speaking of the requirement of contemporaneous ownership found in Rule 23 (b), said (p. 79):

> "• • • those provisions, directed particularly to the shareholder's derivative action to recover for misdeeds of corporate officials, cannot, even if so perhaps intended, override the direct mandate of §16(b) that suit may be brought 'by the owner of any security' without qualification."

Petitioner submits that whatever may be the rights of those "security owners" who are not "shareholders", a shareholder, such as respondent Magida, who brings an action under Section 16(b) must comply with the requirement of contemporaneous ownership set forth in that Rule.

This Court has not passed on this important question of federal law. Thus it has not been, but should be, settled by this Court as contemplated by its Rule 19.

Moreover, the Court below has decided this federal question in a way to conflict with applicable decisions of this Court, another basis for review set forth in Rule 19.

The requirement that a shareholder bringing a derivative suit be such at the time of the transaction of which he complains has its very origin in the decisions of this Court. Thus, commencing with *Hawes* v. *Oakland,* 104 U. S. 450, decided three-quarters of a century ago, this Court has said that there must be (p. 461):

> "• • • an allegation that complainant was a shareholder at the time of the transactions of which he complains."

This Court, subsequent to *Hawes* v. *Oakland*, adopted in succession Equity Rule 94, Equity Rule 27 and the present Federal Rule of Civil Procedure 23, all requiring contemporaneous ownership. The very language of Rule 23(b) is obviously borrowed from the language of *Hawes* v. *Oakland*.

The evil condemned by this Court, and by its rules culminating in Rule 23(b), is the same, *viz.* the purchase of stock in order to institute litigation. As the late Mr. Justice Jackson of this Court so well expressed it in *Cohen* v. *Beneficial Loan Corp.*, 337 U. S. 541, 556:

> "* * * Rule 23 requires the stockholder's complaint to be verified by oath and to show that the plaintiff was a stockholder at the time of the transaction of which he complains or that his shares thereafter devolved upon him by operation of law. In other words, the federal court will not permit itself to be used to litigate a purchased grievance or become a party to speculation in wrongs done to corporations. * * *"

The evil which this Court has thus repeatedly condemned is growing to alarming proportions in Section 16(b) cases. The record in this case alone discloses that the attorney of record of the respondent Magida has been the attorney of record or counsel in *thirteen* other Section 16(b) suits, *in each of which the plaintiff aquired his status as a shareholder subsequent to the action of which he complained* (Ex. 65-66).

Finally, nothing in the Act itself warrants departure from the holding of this Court and the requirement of Rule 23(b). Even if the Act, considered alone, could be construed as not requiring compliance with the principle of contemporaneous ownership, its provisions must yield to

the requirement of Rule 23(b). This Rule was adopted as one of the Federal Rules of Civil Procedure, with the force of law, subsequent to the passage of the Act, and the repealer section of the rule-making statute struck down any conflicting prior law. It provided (28 U. S. C. §2072):

> "All laws in conflict with such rules shall be of no further force or effect after such rules have taken effect."

In this connection, see *Winsor v. Daumit*, 179 F. 2d 475, 477 (7th Cir. 1950).

For all these reasons this Court should settle the question whether one who brings a suit pursuant to Section 16(b) of the Act must comply with Rule 23(b) of the Federal Rules of Civil Procedure.

Conclusion.

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

MARK F. HUGHES,
Counsel for Petitioner, Continental Can Company, Inc.

Of Counsel:

WILLKIE OWEN FARR GALLAGHER & WALTON,
VINCENT R. FITZPATRICK.

Appendix A.

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 275—OCTOBER TERM, 1955.

(Argued March 5, 1956 Decided April 2, 1956)

DOCKET NO. 23904

PAUL MAGIDA, a stockholder of THE VULCAN DETINNING COMPANY, suing on behalf of himself and all other stockholders similarly situated, and on behalf and in the right of THE VULCAN DETINNING COMPANY,
Plaintiff-Appellee,

v.

CONTINENTAL CAN COMPANY, INC.,
Defendant-Appellant,

and

THE VULCAN DETINNING COMPANY,
Defendant-Appellee.

Before:

CLARK, Chief Judge, MEDINA, Circuit Judge, and GALSTON, District Judge.

Appeal from the United States District Court for the Southern District of New York, Sylvester J. Ryan, Judge.

Continental Can Company, Inc., appeals from a judgment against it under §16(b) of the Securities Exchange Act of

1934, 15 U. S. C. §78p(b), for short-swing profits realized by it on its sale of common stock of The Vulcan Detinning Company. Affirmed.

See also *Magida* v. *Continental Can Co.*, D. C. S. D. N. Y., 12 F. R. D. 74.

Morris J. Levy, New York City, for plaintiff-appellee.

Mark F. Hughes, New York City (Willkie, Owen, Farr, Gallagher & Walton and Vincent R. FitzPatrick, New York City, on the brief), for defendant-appellant.

Clark, Chief Judge:

This is an action under §16(b) of the Securities Exchange Act of 1934, 15 U. S. C. §78p(b), for recovery of short-swing profits claimed to be due The Vulcan Detinning Company on a purchase and sale of its common stock by Continental Can Company, Inc., owner of more than 10 per cent of Vulcan's equity securities. The action is brought by one Paul Magida, a stockholder of Vulcan. Judge Ryan gave judgment for plaintiff in right of the corporation for the amount of the profits, plus interest from the date of realization.

In April, 1950, Continental purchased 4,115 shares of Vulcan common stock at a cost of $118,279.25 from the executor of the estate of F. P. Assman, to whom letters testamentary were issued in September, 1947. At the time of Assman's death in August, 1947, he had owned 823 shares of Class A stock, which in February, 1948, were exchanged for the 4,115 shares later sold to Continental. On August 31, 1950, each share of Vulcan common stock was reclassified into two shares. On September 12, 1950, Continental sold 120,000 shares at $20.25 per share, resulting in a net profit on the 4,115 shares of $34,551.85. This is the amount here in issue.

In March, 1951, plaintiff purchased ten shares of Vulcan common stock; and in May, 1951, through his attorney, he requested Vulcan to institute suit to recover the profit concededly made by Continental on the sale. The president of Vulcan refused to do so on the grounds that the sale was made at Vulcan's suggestion and for the best interest of Vulcan stockholders, and that to bring such suit would clearly violate the principles of fair play. More than sixty days thereafter plaintiff instituted this suit against Continental and Vulcan.

Continental pleaded three affirmative defenses, and at the trial moved for leave to amend its answer so as to plead a fourth complete affirmative defense and an additional partial affirmative defense. Neither the third defense nor the additional partial defense is urged here.[1] Of those before us, the first defense alleged, in substance, that Vulcan and its stockholders were estopped from claiming any profits realized by it on the purchase and sale of Vulcan common stock and that any such recovery would be unjust, inequitable, and unconscionable, since the sale was made at the specific instance and request of Vulcan, was in its best interest and that of its stockholders, and was made pursuant to a plan conceived, developed, promoted, and consummated by Vulcan.

Conceding that the sale was made at Vulcan's request and for Vulcan's advantage, it also appears that the sale was of benefit to Continental because it would release to Continental a substantial amount of cash not presently available for use in its business. Further, Continental was the owner of more than a majority of Vulcan's voting securities, and Continental's affirmative vote was essential before any proposition could be approved by the stockholders of Vulcan. Judge Ryan could therefore justifiably

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[1] The defense that Magida did not own his stock at the time of the purchase and sale was negatived by *Blau* v. *Mission Corp.*, 2 Cir., 212 F. 2d 77, certiorari denied *Mission Corp.* v. *Blau*, 347 U. S. 1016. The partial defense that no counsel fee should be allowed appellee's attorney was ruled by the judge a matter for consideration on later application for such fee.

find that the sale "was the free act, choice and decision of both Continental and Vulcan and that it served the interests of both."

But, apart from these factual considerations negativing the existence of an estoppel based on equitable principles, we think that as a matter of law the language and purpose of the statute preclude an estoppel based upon instigation by or benefit to the corporation whose shares are traded. See *Park & Tilford* v. *Schulte*, 2 Cir., 160 F. 2d 984, 989, note 1, certiorari denied 332 U. S. 761; *Pellegrino* v. *Nesbit*, 9 Cir., 203 F. 2d 463, 467, 37 A. L. R. 2d 1296; *Jefferson Lake Sulphur Co.* v. *Walet*, D. C. E. D. La., 104 F. Supp. 20, affirmed *Walet* v. *Jefferson Lake Sulphur Co.*, 5 Cir., 202 F. 2d 433, certiorari denied 346 U. S. 820. Even though Continental may have acted in good faith, may have overlooked the April purchase at the time of sale, and may not have made use of inside information of which the other stockholders were ignorant, these factors cannot operate to negate the statutory liability which exists "irrespective of any intention on the part of such beneficial owner • • •." Securities Exchange Act of 1934, §16(b), 15 U. S. C. §78p (b). See *Gratz* v. *Claughton*, 2 Cir., 187 F. 2d 46, 49, certiorari denied 341 U. S. 920; *Smolowe* v. *Delendo Corp.*, 2 Cir., 136 F. 2d 231, 148 A. L. R. 300, certiorari denied *Delendo Corp.* v. *Smolowe*, 320 U. S. 751.

Since the policy of the statute is to protect minority stockholders and the public against manipulated market fluctuations, certainly this stockholder, who became such after the acts in question had taken place, cannot be estopped by corporate acts, even those having the apparent approval of a majority of stockholders. The action under §16(b) is derivative in the sense that the corporation is the instrument, sometimes unwilling, for the effectuation of the statutory policy; but this so-called derivative nature of the right, when coupled with the doctrine of estoppel, cannot serve to defeat the very policy it was created to advance.

Appellant further contends that the securities are exempt from the operation of the Act by virtue of SEC Rule X-16A-4, 17 CFR §240.16a-4, which at the time of

In March, 1951, plaintiff purchased ten shares of Vulcan common stock; and in May, 1951, through his attorney, he requested Vulcan to institute suit to recover the profit concededly made by Continental on the sale. The president of Vulcan refused to do so on the grounds that the sale was made at Vulcan's suggestion and for the best interest of Vulcan stockholders, and that to bring such suit would clearly violate the principles of fair play. More than sixty days thereafter plaintiff instituted this suit against Continental and Vulcan.

Continental pleaded three affirmative defenses, and at the trial moved for leave to amend its answer so as to plead a fourth complete affirmative defense and an additional partial affirmative defense. Neither the third defense nor the additional partial defense is urged here.[1] Of those before us, the first defense alleged, in substance, that Vulcan and its stockholders were estopped from claiming any profits realized by it on the purchase and sale of Vulcan common stock and that any such recovery would be unjust, inequitable, and unconscionable, since the sale was made at the specific instance and request of Vulcan, was in its best interest and that of its stockholders, and was made pursuant to a plan conceived, developed, promoted, and consummated by Vulcan.

Conceding that the sale was made at Vulcan's request and for Vulcan's advantage, it also appears that the sale was of benefit to Continental because it would release to Continental a substantial amount of cash not presently available for use in its business. Further, Continental was the owner of more than a majority of Vulcan's voting securities, and Continental's affirmative vote was essential before any proposition could be approved by the stockholders of Vulcan. Judge Ryan could therefore justifiably

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[1] The defense that Magida did not own his stock at the time of the purchase and sale was negatived by *Blau* v. *Mission Corp.*, 2 Cir., 212 F. 2d 77, certiorari denied *Mission Corp.* v. *Blau*, 347 U. S. 1016. The partial defense that no counsel fee should be allowed appellee's attorney was ruled by the judge a matter for consideration on later application for such fee.

find that the sale "was the free act, choice and decision of both Continental and Vulcan and that it served the interests of both."

But, apart from these factual considerations negativing the existence of an estoppel based on equitable principles, we think that as a matter of law the language and purpose of the statute preclude an estoppel based upon instigation by or benefit to the corporation whose shares are traded. See *Park & Tilford* v. *Schulte*, 2 Cir., 160 F. 2d 984, 989, note 1, certiorari denied 332 U. S. 761; *Pellegrino* v. *Nesbit*, 9 Cir., 203 F. 2d 463, 467, 37 A. L. R. 2d 1296; *Jefferson Lake Sulphur Co.* v. *Walet*, D. C. E. D. La., 104 F. Supp. 20, affirmed *Walet* v. *Jefferson Lake Sulphur Co.*, 5 Cir., 202 F. 2d 433, certiorari denied 346 U. S. 820. Even though Continental may have acted in good faith, may have overlooked the April purchase at the time of sale, and may not have made use of inside information of which the other stockholders were ignorant, these factors cannot operate to negate the statutory liability which exists "irrespective of any intention on the part of such beneficial owner • • •." Securities Exchange Act of 1934, §16(b), 15 U. S. C. §78p (b). See *Gratz* v. *Claughton*, 2 Cir., 187 F. 2d 46, 49, certiorari denied 341 U. S. 920; *Smolowe* v. *Delendo Corp.*, 2 Cir., 136 F. 2d 231, 148 A. L. R. 300, certiorari denied *Delendo Corp.* v. *Smolowe*, 320 U. S. 751.

Since the policy of the statute is to protect minority stockholders and the public against manipulated market fluctuations, certainly this stockholder, who became such after the acts in question had taken place, cannot be estopped by corporate acts, even those having the apparent approval of a majority of stockholders. The action under §16(b) is derivative in the sense that the corporation is the instrument, sometimes unwilling, for the effectuation of the statutory policy; but this so-called derivative nature of the right, when coupled with the doctrine of estoppel, cannot serve to defeat the very policy it was created to advance.

Appellant further contends that the securities are exempt from the operation of the Act by virtue of SEC Rule X-16A-4, 17 CFR §240.16a-4, which at the time of

these transactions exempted from the operation of §§16(a) and (b) "securities held in the estate of a deceased person during a period of 2 years following the appointment and qualification of the executor or administrator." Effective November 1, 1952, this rule was revised to read as follows:

> "(a) During the period of twelve months following their appointment and qualification, securities held by the following persons shall be exempt from sections 16(a) and (b):
>
> "(1) Executors or administrators of the estate of a decedent;"

Although appellant contends that this revised rule is a departure from the meaning of the previous one, it is in fact (except for the change in time period) only a clarification.[2] See Cook & Feldman, *Insider Trading under the Securities Exchange Act*, 66 Harv. L. Rev. 385, 390. Under the old rule, therefore, the exemption attaches only during the 2-year period; and, since in this case the purchase admittedly took place more than 2 years after the qualification of the executor, the rule has no application. Appellant's position, apparently to the effect that once the shares have been held in an estate for the required 2 years they are endowed wherever held with an exemption of indefinite duration, is transparently fallacious.

Finally, we reach the question of the legal sufficiency of the proposed complete defense alleging that the suit was champertous.[3] Judge Ryan refused to allow amend-

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[2] SEC Release No. 4754, dated Sept. 24, 1952, reads as follows:

> "The new rule X-16A-4 clarifies the prior rule by indicating that the exemption provided in the rule is applicable only when the securities were held by the persons enumerated in the rule. It also reduces the period of time during which the exemption is effective from two years to one year."

[3] "For a Fourth Separate and Complete Defense.

> "17. Upon information and belief, that the action has been commenced and prosecuted not on behalf of the defendant Vulcan Detinning Company and its stockholders, but for the benefit of the attorney for the plaintiff and for the pur-

ment of the answer to include this defense. He did, however, permit an offer of proof, consisting primarily of depositions, purporting to show that plaintiff's attorney is the real party in interest, that his sole motive in prosecuting the action is to obtain a counsel fee, and that no true relation of attorney and client exists.

Continental argues the improbability of plaintiff's having instituted the action unless his attorney had undertaken the expenses of suit. For (by defendant's calculation) plaintiff, the holder of ten shares of Vulcan common stock, can, if successful in this action, hope to increase his personal equity interest in Vulcan by $1.10; while if unsuccessful, he would be liable for costs and expenses aggregating many hundred times that amount. Plaintiff's attorney, Markowitz, not now the attorney of record, in his deposition testified that plaintiff, under the terms of an oral retainer, had undertaken to pay such costs and expenses. The true facts of the arrangements between them were, however, heavily obscured by numerous invocations of the attorney-client privilege by the attorney of record. See *Magida* v. *Continental Can Co.*, D. C. S. D. N. Y., 12 F. R. D. 74.

But we think that, even if the proposed Fourth Defense were fully capable of proof, it would be insufficient in law to defeat the suit. The action is brought on behalf of the corporation to protect the rights of stockholders and of the public. The relationship between his attorney and the plaintiff, who is the mere vehicle of recovery, cannot defeat

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pose and with the intention that said attorney shall receive an attorney's fee out of any amount that may be recovered by way of judgment in the action; that no bona fide relationship of attorney and client exists between the plaintiff and his attorneys; that the arrangement between the plaintiff and his attorneys by which the action is being prosecuted is illegal and in violation of law and specifically is a violation of Section 274 of the New York Penal Law and is contrary to the public policy of the State of New York and of the United States and that any recovery in the action would be contrary to the public policy of the State of New York and of the United States and would be unjust, inequitable and unconscionable."

the rights of the corporation and other stockholders, to whom the recovery accrues. See *Young* v. *Higbee*, 324 U. S. 204, 214; *Magida* v. *Continental Can Co., supra*, D. C. S. D. N. Y., 12 F. R. D. 74, 78.

If there has been a violation of N. Y. Penal Law §274 as alleged, offenders are liable to its criminal sanction. But the public policy of New York cannot nullify this federally created right, established for the effectuation of a broad federal policy. So *Peck* v. *Heurich*, 167 U. S. 624, and *Merlaud* v. *National Metropolitan Bank of Washington, D. C.*, D. C. Cir., 84 F. 2d 238, certiorari denied 299 U. S. 584, cited by appellant, are distinguishable in that in both the plaintiff acquired his status as such through champertous acts, whereas here the plaintiff's position as vindicator of the corporate rights comes from the statute itself.

Judge Ryan has specifically reserved these matters as alleged by Continental for later consideration in connection with the allowance of a reasonable attorney's fee. A showing of misconduct is naturally pertinent to the determination of an appropriate fee.

Although an allowance of interest from the time of realization of profit is not mandatory, we see no reason to deny it here. See *Park & Tilford* v. *Schulte, supra*, 2 Cir., 160 F. 2d 984, certiorari denied 332 U. S. 761; *Blau* v. *Mission Corp.*, 2 Cir., 212 F. 2d 77, certiorari denied *Mission Corp.* v. *Blau*, 347 U. S. 1016. That portion, too, of the judgment below we find fully authorized.

Judgment affirmed.

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT.

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the 2nd day of April one thousand nine hundred and fifty-six.

Present:

Hon. CHARLES E. CLARK,
Chief Judge

Hon. HAROLD R. MEDINA,
Circuit Judge

Hon. CLARENCE G. GALSTON,
District Judge

PAUL MAGIDA, a Stockholder of THE VULCAN DETINNING CO., etc.,
Plaintiff-Appellee,

v.

CONTINENTAL CAN CO., INC.,
Defendant-Appellant,

VULCAN DETINNING CO.,
Defendant-Appellee.

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the Judgment of said District Court be and it hereby is AFFIRMED.

A. DANIEL FUSARO,
Clerk.

Appendix B.

The pertinent provisions of the Securities and Exchange Act of 1934 are as follows:

"DIRECTORS, OFFICERS, AND PRINCIPAL STOCKHOLDERS

"Sec. 16. (a) Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered on a national securities exchange, * * * shall file, * * * within ten days after he becomes such beneficial owner, * * * a statement with the exchange (and a duplicate original thereof with the Commission) of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter, if there has been any change in such ownership during such month, shall file with the exchange a statement (and a duplicate original thereof with the Commission) indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month.

"(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for

a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

(15 U. S. C. 78p (a) and (b)).

Rule 23 of the Federal Rules of Civil Procedure provides as follows:

"CLASS ACTIONS.

(a) Representation. If persons constituting a class are so numerous as to make it impracticable to bring them all before the court, such of them, one or more, as will fairly insure the adequate representation of all may, on behalf of all, sue or be sued, when the character of the right sought to be enforced for or against the class is

(1) joint, or common, or secondary in the sense that the owner of a primary right refuses to enforce that right and a member of the class thereby becomes entitled to enforce it;

(2) several, and the object of the action is the adjudication of claims which do or may affect specific property involved in the action; or

(3) several, and there is a common question of law or fact affecting the several rights and a common relief is sought.

(b) Secondary Action by Shareholders. In an action brought to enforce a secondary right on the part of one or more shareholders in an association, incorporated or unincorporated, because the association refuses to enforce rights which may properly be asserted by it, the complaint shall be verified by oath and shall aver (1) that the plaintiff was a shareholder at the time of the transaction of which he complains or that his share thereafter devolved on him by operation of law and (2) that the action is not a collusive one to confer on a court of the United States jurisdiction of any action of which it would not otherwise have jurisdiction. The complaint shall also set forth with particularity the efforts of the plaintiff to secure from the managing directors or trustees and, if necessary, from the shareholders such action as he desires, and the reasons for his failure to obtain such action or the reasons for not making such effort.

(c) Dismissal or Compromise. A class action shall not be dismissed or compromised without the approval of the court. If the right sought to be enforced is one defined in paragraph (1) of subdivision (a) of this rule notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs. If the right is one defined in paragraphs (2) or (3) of subdivision (a) notice shall be given only if the court requires it.'

MAY 13 1956
HAROLD B. WILLEY, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1955

No. 937

CONTINENTAL CAN COMPANY, INC.,
Petitioner,

against

PAUL MAGIDA, a stockholder of The Vulcan Detinning Company, suing on behalf of himself and all other stockholders similarly situated and on behalf of and in the right of The Vulcan Detinning Company,

and

THE VULCAN DETINNING COMPANY,
Respondents.

BRIEF FOR RESPONDENT, PAUL MAGIDA, IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

MORRIS J. LEVY,
Attorney for Respondent,
Paul Magida,
261 Broadway,
New York 17, N. Y.

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Opinions Below

The opinion of the District Court (R., pp. 421-430) has not yet been reported officially.

The opinion of the United States Court of Appeals (R., pp. 431-434, Pet. Append. A, pp. 14-20) has not yet been reported officially.

Jurisdiction

The judgment of the United States Court of Appeals was entered April 2, 1956. Jurisdiction of this Court is invoked under Section 1254 of Title 28, United States Code, which is made applicable by Section 27 of the Securities Exchange Act of 1934 (15 U. S. C. A., Sect. 78aa).

The Statutes

Sections 16(a) and 16(b) of the Securities Exchange Act of 1934, 15 U. S. C. A., Sections 78p(a) and 78p(b), provide as follows:

> "(a) Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered on a national securities exchange, or who is a director or an officer of the issuer of such security, shall file, at the time of the registration of such security or within ten days after he becomes such beneficial owner, director, or officer, a statement with the exchange (and a duplicate original thereof with the Commission) of the amount of all equity securities of such issue of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter, if there has been any change in such ownership during such month, shall file with the exchange a statement (and a duplicate original thereof with the Commission) indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month.
>
> "(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him

from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

Section 27 of the Securities Exchange Act of 1934 (Section 78aa of Title 15 U. S. C. A.) so far as here pertinent, provides as follows:

"The district courts of the United States, the Supreme Court of the District of Columbia, and the United States courts of a Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this title or the rules and regulations thereunder, and of all suits in

equity and actions at law brought to enforce any liability or duty created by this title or the rules and regulations thereunder. * * *"

Summary Statement of the Matter Involved

The questions of law presented by the petition for writ of certiorari are predicated entirely upon the particular facts herein set forth and are of limited application for the administration of the statutes involved. The facts are peculiar to the petitioner and are not of general incidence.

The respondent, Paul Magida, a stockholder of The Vulcan Detinning Company (hereinafter referred to as Vulcan), commenced an action on its behalf and for its benefit pursuant to the provisions of Section 16(b) of the Securities Exchange Act of 1934 to recover the "short-swing" profits realized by petitioner, Continental Can Company, Inc. (hereinafter referred to as Continental), the beneficial owner of more than ten (10%) per cent of Vulcan's equity securities.

In the courts below the petitioner conceded that if its affirmative defenses were deemed insufficient, then the corporate defendant, Vulcan, on whose behalf and for whose benefit the suit was brought, would be entitled to a judgment in the sum of $34,551.85.

Upon the trial of this action the petitioner urged that relief should be denied to *Vulcan* because the respondent stockholder was not a shareholder of Vulcan at the time petitioner effected its "short-swing" transactions. The Court ruled that this defense was insufficient in law, and petitioner did not urge this point upon its appeal before the United States Court of Appeals.

Upon the trial the petitioner, *for the first time,* moved to amend its answer so as to plead an additional affirmative defense by alleging therein that the action was not

commenced for the benefit of Vulcan but for the alleged purpose of affording respondent-stockholder's attorney an opportunity of earning a fee, and that the arrangement between respondent-stockholder and his attorney was allegedly illegal and contrary to public policy.

The trial Court, although permitting petitioner to make a full offer of proof, ruled that the proposed amendment was insufficient in law, and denied petitioner's motion to amend. The United States Court of Appeals affirmed the trial Court's ruling with respect to petitioner's proposed amendment, holding that "even if the proposed Fourth Defense were fully capable of proof, it would be insufficient in law to defeat the suit" because "the relationship between his attorney and the plaintiff, who is the mere vehicle of recovery, cannot defeat the rights of the corporation and other stockholders, to whom the recovery accrues".

The United States Court of Appeals affirmed the judgment of the District Court in favor of Vulcan and against the petitioner herein.

Issues Presented

1. In an action brought by a stockholder for the benefit of his corporation pursuant to Section 16(b) of the Securities Exchange Act of 1934, must the plaintiff stockholder have been a shareholder of his corporation at the time the "short-swing" transactions occurred?

2. Are the alleged motives or actions of a stockholder in bringing a suit for the benefit of his corporation pursuant to Section 16(b) of the Securities Exchange Act of 1934 legally sufficient to defeat a recovery thereunder by the corporation?

POINT I

Since jurisdiction of this action is conferred upon the Court by the Securities Exchange Act of 1934 and is expressly dependent upon the Federal question involved and *not* upon diversity of citizenship, plaintiff need not comply with the provisions of Rule 23(b) of the Federal Rules of Civil Procedure.

The substance of petitioner's third affirmative defense is that the respondent-stockholder "was not the owner and holder of shares of common stock" of Vulcan during the periods in which petitioner effected its short-swing transactions, and that respondent cannot, therefore, maintain this suit.

The provisions of Rule 23(b) of the Federal Rules of Civil Procedure provides in substance that any derivative action brought by a stockholder must allege in his complaint that he was such stockholder "at the time of the transaction of which he complains or that his stock thereafter devolved upon him by operation of law".

The fallacy of petitioner's aforesaid defense is quite obvious. Jurisdiction of this Court in this suit is *not* dependent upon diversity of citizenship but is *expressly* conferred by the provisions of Section 27 of the Securities Exchange Act of 1934, 15 U. S. C. A., Section 78aa, which, in so far as is here material provides as follows:

> "The district courts of the United States, * * * shall have *exclusive* jurisdiction of violations of this title or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this title or the rules and regulations thereunder." (Italics supplied.)

Thus, it is patently clear that jurisdiction of a 16(b) suit is *not* dependent upon diversity of citizenship but rather upon the express provisions of the federal statute itself.

Federal Rule 23(b), which is substantially the same as former Equity Rule 27, was designed to prevent collusive suits to obtain federal jurisdiction on the basis of *diversity of citizenship.* Compliance with the rule is not necessary to the jurisdiction of the Court since the rule goes *not* to the jurisdiction but only to the manner in which it is exercised. Since the prime reason for compliance with the rule is non-existent when jurisdiction is not based on diversity, the courts have held that the rule need not be followed.

Thus, in *Hand* v. *Kansas City Southern Ry. Co.* (D. C. S. D. N. Y.) 55 F. 2d 712, the Court said:

> "The first portion of Rule 27. *i. e.,* that a stockholder must have been such at the time of the commission of the wrongs complained of and that the suit is not collusive, has no application to cases depending upon a federal question. It applies only to cases where jurisdiction is based upon diversity of citizenship; *Lindsley* v. *Natural Carbonic Gas Co.* (C. C.), 162 F. 954. It was intended to exclude only cases brought by a stockholder collusively to give apparent jurisdiction to a court, which, but for the citizenship of the plaintiff, would not exist. *Kelly* v. *Dolan,* D. C., 218 F. 966."

In *Benisch* v. *Cameron* (D. C. S. D. N. Y.), 81 F. Supp. 882, the Court, in holding that Rule 23(b) has no applicability to a Section 16(b) suit, stated:

> "Although the right of action created by Section 16(b) is somewhat akin to the ordinary stockholders' derivative suit, it is plain from the reasons set forth

in Sect. 2 of the Act (15 U. S. C. A., Sect. 78(b) and in the preamble to Section 16(b), that it was primarily intended as an 'instrument of a statutory policy' of which the general public is the ultimate beneficiary. Congress did not intend procedural restrictions to hamper such policy,

"A further manifestation of this purpose is evident from the fact that suit might be instituted by any 'security' holder of the issuer. And 'Security' is defined in Section 3 (15 U. S. C. A., Sect. 78(c) as '• • • any note, treasury stock, etc'.

"Congress, therefore, could never have intended compliance with Rule 23(b) as a prerequisite to suit because the 'security' holders authorized to sue under 16(b), other than a shareholder, cannot, by reason of their status, make averment required by Rule 23(b).

"I hold that plaintiff need not comply with Rule 23(b)."

In *Pellegrino* v. *Nesbit* (C. A. 9), 203 F. 2d 463, the Court, in holding that plaintiff stockholder in a 16(b) suit need not comply with Rule 23(b), said:

"• • • The statute states that where an issuer fails to bring suit within sixty days after request or fails diligently to prosecute the same thereafter 'the owner of *any security* of the issuer' (italics ours) may institute suit. Such suit is 'in behalf of the issuer' rather than for the personal benefit of the stockholder plaintiff. *Thus the stockholder need not have owned stock at the time of the transaction of which he complains took place. Benisch* v. *Cameron,* 81 F. Supp. 882 (S. D. N. Y., 1948)." (Italics supplied.)

In *Blau* v. *Mission Corporation* (C. A. 2), 212 F. 2d 77, 79, Cert. denied, 347 U. S. 1016, 74 S. Ct. 872, 98 L. Ed.

1138, the Court, in again holding that a plaintiff stockholder in a Section 16(b) suit need not comply with Rule 23(b), stated:

> "• • • The complaint is not defective for failure to allege that plaintiff was a shareholder at the time of the transaction complained of in accordance with Fed. Rules Civ. Proc. rule 23(b), • • •; those provisions directed particularly to the shareholder's derivative action to recover for misdeeds of corporate officials, cannot, even if so perhaps intended, override the direct mandate of Section 16(b) that suit may be brought 'by the owner of any security' without qualification. *Pellegrino* v. *Nesbit*, 9 Cir. 203 F. 2d 463; *Park & Tilford, Inc.* v. *Schulte*, 2 Cir. 160 F. 2d 984, certiorari denied, *Schulte* v. *Park & Tilford, Inc.*, 332 U. S. 761, 68 S. Ct. 64, 92 L. Ed. 347; *Kogan* v. *Schulte*, D. C. S. D. N Y., 61 F. Supp. 604."

Finally, in *Dottenheim* v. *Murchison* (C. A. 5), 227 F. 2d 737, cert. denied April 30, 1956, the Court cited with approval the cases of *Blau* v. *Mission Corporation, supra,* and *Pellegrino* v. *Nesbit, supra,* in holding that compliance with Rule 23(b) is not required in a suit brought under Section 16(b) of the Securities Exchange Act of 1934.

Thus, it is apparent that every appellate court in which the question has been presented has with *uniformity* decided that a stockholder who brings an action under Section 16(b) of the Securities Exchange Act of 1934 is not required to have been a shareholder at the time the "short-swing" transactions occurred.

POINT II

The alleged motives or actions of a stockholder in bringing suit for the benefit of his corporation under Section 16(b) of the Securities Exchange Act of 1934 is legally insufficient to defeat a recovery thereunder by the corporation.

Upon the opening of the trial the petitioner moved for leave to amend its answer for the purpose of adding thereto a "Fourth Separate and Complete Defense" which in substance alleged that the action was not commenced for the benefit of Vulcan and its stockholders but for the alleged purpose of affording respondent-stockholder's attorney an opportunity of earning a fee, and that the arrangement between the respondent and his attorney was allegedly illegal and contrary to public policy* (R., p. 2).

In denying petitioner's motion to plead its proposed defense as insufficient in law, the trial Court, however, permitted petitioner to make a complete offer of proof with respect thereto (R., pp. 86-96).

Apart from the fact that Section 16(b) of the Securities Exchange Act of 1934 conferred a license upon respondent-stockholder to commence suit on Vulcan's behalf upon its failure or refusal to do so, and apart from the fact that respondent's motives in instituting this action

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* Petitioner stated that its offer of proof consisted of *"circumstantial evidence* from which the court could draw that *inference."* (R., p. 87). Although petitioner argued at length in the courts below that "Any agreement between attorney and client by which the attorney undertakes to bear the costs and expenses of the litigation is illegal and champertous", and sought to *impute* such conduct to respondent and his attorneys, *the uncontroverted testimony in petitioner's offer of proof* conclusively proves that the agreement between respondent and his attorneys provided that the *respondent-stockholder,* not his attorneys, "would be responsible for the expenses incurred in the litigation." (R., p. 237).

were wholly proper and highly commendable as being in line with the salutary public policy envisioned and stated in the Act, this Court has made the following statement in *Young* v. *Higbee,* 324 U. S. 204, 65 S. Ct. 594, 89 L. Ed. 894 (p. 214):

> "Nor can we sustain the contention that relief should be denied on the allegations that Young's motive in bringing the proceeding is an unworthy one. His petition sought relief for the benefit of all the stockholders. *The rights of these stockholders are not to be ignored because of some motive attributable to Young.*" (Italics supplied.)

And in *Pellegrino* v. *Nesbit* (C. A. 9), *supra,* an action involving the recovery of "short-swing" profits under Section 16(b) of the Act, where the stockholder's motives in bringing suit on behalf of his corporation was attacked, the Court said:

> "In view of the statutory policy involved we need not be concerned with either the substantiality of appellant's shareholder interest, see *Twentieth Century-Fox-Film Corp.* v. *Jenkins,* D. C. S. D. N. Y., 1947, 7 F. R. D. 197, *or appellant's motive in seeking to take part in the litigation. Magida* v. *Continental Can Co.,* D. C. S. D. N. Y., 1951, 12 F. R. D. 74; *Cf., Young* v. *Higbee Co.,* 1945, 324 U. S. 204, 65 S. Ct. 594, 89 L. Ed. 890." (Italics supplied.)

And in *Johnson* v. *King-Richardson Co.* (C .C. A. 1), 36 F. 2d 675, 677, the Court said:

> "The rule generally prevailing is that where a suitor is entitled to relief in respect to the matter concerning which he sues, *his motives are immaterial;* that the legal pursuit of his rights, *no matter what his motive in bringing the action, cannot be deemed either illegal*

or inequitable; and that he may always insist upon his strict rights and demand their enforcement. * * *" (Italics supplied.)

The Court below correctly ruled that since respondent-stockholder is merely the vehicle through which the "short-swing" profits realized by petitioner may be recovered by *Vulcan and its stockholders,* any collateral issues, such as darkly hinted motives and suspicions which petitioner is seeking to attribute to respondent, has absolutely no legal sufficiency with respect to *Vulcan's right* to recover under Section 16(b) of the Securities Exchange Act of 1934.

POINT III

The reasons asserted by petitioner for issuing the writ of certiorari are not valid.

This case involves questions of construction of Sections 16(b) and 27 of the Securities Exchange Act of 1934. The only cases which have heretofore interpreted these parts of the Act have been decided by three different Circuits of the Appellate Court. *Each* of these courts has interpreted these Sections of the Act *uniformly* and there is no conflict among those decisions. Petitioner has been unable to point out even one appellate court decision which might even suggest any conflict as to the interpretations of Sections 16(b) and 27 of the Act.

Petitioner asserts that the statement in the opinion of the Court below, that "even if the proposed Fourth Defense* were fully capable of proof, it would be insufficient

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* Petitioner's proposed Fourth Defense alleges in substance that this action was not commenced for the benefit of Vulcan and its stockholders but for the alleged purpose of affording respondent-stockholder's attorneys an opportunity of earning a fee, and that the arrangement between the respondent and his attorney was allegedly illegal, champertous and contrary to public policy.

in law to defeat the suit", is allegedly in conflict with *Peck* v. *Heurich*, 167 U. S. 624 (1897); *Merland* v. *National Metropolitan Bank*, 84 F. 2d 238, and *General Film Co.* v. *Sampliner*, 252 F. 443.

It is respectfully submitted that in each of the aforesaid cases cited by petitioner, the plaintiff *purchased the claim* for the specific purpose of bringing suit thereon and concededly sharing any proceeds therefrom with the client; none of the aforesaid cases involved any suit by a stockholder to enforce the rights of his corporation for the benefit of the corporation and its stockholders; nor did any of the aforesaid cases involve the enforcement of a federal statute enacted specifically to effectuate a much needed public policy.

In overruling the same argument advanced by petitioner in the Court below, that Court pointed out that the aforesaid cases are distinguishable from the present one because in those cases "the plaintiff *acquired his status* as such through champertous acts, whereas here the plaintiff's position as a vindicator of the corporate rights comes from *the statute itself*" (Pet. Append. A, p. 20).

From the standpoint of interest, this case merely involves an asserted liability of an insider to a private corporation on the special facts presented. From the standpoint of legal issues, this case presents only a question of the proper interpretations of Sections 16(b) and 27 of the Securities Exchange Act of 1934. It is submitted that these are not matters of national scope, or of great concern to the investing public of the United States.

Despite the publication of the opinions below and knowledge that this case was pending by members of the Securities and Exchange Commission, that body has made no effort to participate in this private litigation. The Commission is known to be both alert and painstaking where important matters involving construction or interpretations of the Securities Acts are concerned.

It seems fair to say that the non-action by the Commission under the circumstances indicates at least a tacit acquiescence in the interpretations of the Act reached by the Court below.

The case has been correctly decided and this Court should not be required to pass upon it again. Further review is not warranted.

CONCLUSION

The petition for a writ of certiorari should be denied.

May 17, 1956.

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HAROLD B. WILLEY,

IN THE

Supreme Court of the United States

OCTOBER TERM, 1955.

No. 937.

CONTINENTAL CAN COMPANY, INC.,

Petitioner,

against

PAUL MAGIDA, a stockholder of THE VULCAN DETINNING COMPANY, suing on behalf of himself and all other stockholders similarly situated and on behalf and in the right of THE VULCAN DETINNING COMPANY,

and

THE VULCAN DETINNING COMPANY,

Respondents.

PETITIONER'S REPLY BRIEF.

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3 *Moore's Federal Practice, Second Edition*, §23.15, p. 3494	1

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THE VULCAN DETINNING COMPANY,

Respondents.

PETITIONER'S REPLY BRIEF.

I.

The brief of respondent Magida (pp. 6-7) asserts that Federal Rule 23(b) is only applicable to actions involving jurisdiction based on diversity of citizenship and cites *Hand* v. *Kansas City Southern Ry. Co.*, 55 F. 2d 712 (D. C. S. D. N. Y. 1931). To the extent that case so holds it has been branded as an anomaly. *Jacobson* v. *General Motors Corporation*, 22 F. Supp. 255 (D. C. S. D. N. Y. 1938). See, also, 3 *Moore's Federal Practice, Second Edition*, §23.15, p. 3494.

II.

The brief of respondent Magida (pp. 5, 10-12) misstates the other question. Petitioner does not raise the question of Magida's motive as a plaintiff. It raises a much more fundamental question—namely, whether Magida was in fact a plaintiff at all. Petitioner contends that he was a dummy and that the only party in interest was his attorney, whose sole motive was a fee. He also erroneously states (Respondent's Br., p. 10, footnote) that petitioner's offer of proof conclusively proved that Magida agreed to be responsible for the expenses of the litigation. Neither Magida nor his attorney of record so testified. The reference is to the deposition of an attorney named Markowitz (Ex. 50).*

III.

Contrary to the contention of respondent Magida, both the questions presented are important and should be reviewed.

A. It is hard to conceive of a more important question than whether Congress intended in Section 16(b) of the Securities Exchange Act of 1934 to override the public policy against champertous and illegal agreements between attorney and client.

B. This Court has never reviewed and passed upon a case involving the impact, if any, of Federal Rule of Civil Procedure 23(b) upon Section 16(b)

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* Reference is to a page of a volume containing petitioner's Exhibits G-1, G-2, G-3, G-4, H, I and J, marked for identification upon the trial of this action and comprising proof in support of the proposed fourth affirmative defense.

of the Act. Surely that question merits review, especially when it is now apparent that lawyers for *ex post facto* stockholders are endeavoring to reap a harvest in this sort of litigation.

Respectfully submitted,

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